Supreme Court, U. S.
FILED
MAY 5 1978
MICHAEL RODAK, JR., CLERK

No. 77-1134

In the Supreme Court of the United States

OCTOBER TERM, 1977

STATE OF MONTANA, ET AL., APPELLANTS

v.

UNITED STATES OF AMERICA

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

MOTION TO AFFIRM

WADE H. MCCREE, JR.,
Solicitor General,

M. CARR FERGUSON,
Assistant Attorney General,

DAVID ENGLISH CARMACK,
Attorney,
Department of Justice,
Washington, D.C. 20530.

INDEX

Page

Statement 1

Argument 5

Conclusion 13

CITATIONS

Cases:

Alabama v. *King & Boozer*, 314 U.S. 1 9

England v. *Medical Examiners*, 375 U.S. 411 11

James v. *Dravo Contracting Co.*, 302 U.S. 134 6

Peter Kiewit Sons' Co. v. *Department of Revenue* (*Kiewit #2*), 166 Mont. 260, 531 P. 2d 1327 ..... 3, 4

Peter Kiewit Sons' Co. v. *State Board of Equalization* (*Kiewit #1*), 161 Mont. 140, 505 P. 2d 102 ..... 3, 4, 9, 11, 12

M'Culloch v. *Maryland*, 4 Wheat. 316 ..... 5, 10

Moses Lake Homes v. *Grant County*, 365 U.S. 744 5

Phillips Chemical Co. v. *Dumas School District*, 361 U.S. 376 ..... 5, 10

United States v. *City of Detroit*, 355 U.S. 466 5

United States v. *County of Fresno*, 429 U.S. 452 ..... 5, 6

Page

Constitution and statutes—continued:

United States Constitution, Supremacy Clause 1, 3, 4, 5, 7, 8, 9

28 U.S.C. 1253 1

Revised Codes of Montana, 1947, Title 84, Chapter 35 (1975 Cum. Supp.) 1, 3

§ 84-3501(1) 2

§ 84-3505 2

§ 84-3514 2

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1134

STATE OF MONTANA, ET AL., APPELLANTS

v.

UNITED STATES OF AMERICA

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

MOTION TO AFFIRM

Pursuant to Rule 16(1)(c) of the Rules of this Court, the appellee, the United States of America, moves that judgment of the district court be affirmed.

STATEMENT

This is a direct appeal under 28 U.S.C. 1253 from a judgment of a three-judge district court (1) declaring that Title 84, Chapter 35, Revised Codes of Montana, 1947, as amended, and the rules and regulations promulgated thereunder, violate the Supremacy Clause of the United States Constitution insofar as they apply to the United States of America, its contractors, subcontractors and those with whom it deals, and (2) permanently enjoining the application of that chapter against those persons (J.S. App. 1-3).[1]

[1] In its judgment, the court ordered that the federal government's claim for refund of the license fee and gross receipts tax be determined by a single-judge district court (J.S. App. 3).

The pertinent facts are as follows:

Section 84-3505, Revised Codes of Montana (1975 Cum. Supp.) (J.S. App. 40) imposes upon public contractors a license fee of one percent of gross receipts derived from public construction contracts performed in Montana for federal, state or local governments.[2] A "public contractor" is any person who submits a proposal, or enters into a contract, to perform any public construction work in Montana for the federal, state or local governments (§ 84-3501(1), Revised Codes of Montana (1975 Cum. Supp.) (J.S. App. 38)).

Private contractors, *i.e.*, those not engaged in government work, are not subject to the gross receipts tax. Nor are the gross receipts of "public contractors" derived from private work subject to the tax (J.S. App. 40-41, 90). Thus, receipts from construction work performed for federal, state or local governments in Montana are subject to a tax that receipts from private work are not (J.S. App. 88, 90).

A contractor may credit against the gross receipts tax the taxes paid on his personal property used in his contracting business in Montana. He may credit the balance of the gross receipts tax against the Montana individual income tax or the corporate license tax (*i.e.*, corporate income tax) (§ 84-3514, Revised Codes of Montana (1975 Cum. Supp.) (J.S. App. 47-48)). The effective rate of the gross receipts tax thus varies among public contractors because of variations in their personal property and income taxes, but it averages approximately one-half of one percent of gross receipts (J.S. App. 11-12, 87-88, 90).

---

[2]There is also an annual license fee of $10 to $200 (depending upon the dollar amount of construction the license authorizes).

The United States brought this action in the United States District Court for the District of Montana in April 1971 against the State of Montana, its Department of Revenue and its Director of Revenue. It sought, *inter alia*, (1) a declaratory judgment that the imposition of the gross receipts tax upon the United States, its contractors, subcontractors or those with whom it dealt violated the Supremacy Clause of the United States Constitution, (2) a permanent injunction against imposing the tax on those persons, and (3) a refund of the taxes collected from those persons (J.S. App. 80-81).[3] The case was continued on stipulation pending resolution in the Montana state courts of *Peter Kiewit Sons' Co.* v. *Department of Revenue*, 166 Mont. 260, 531 P. 2d 1327 (J.S. App. 49-51).

In *Peter Kiewit Sons' Co.* v. *State Board of Equalization*, 161 Mont. 140, 505 P. 2d 102 (*Kiewit #1*), (J.S. App. 105-123) the contractor, in litigation financed and directed by the United States, sought a refund of the gross receipts tax that it had paid on amounts received under contracts with the Department of the Army, contending that the tax unconstitutionally discriminated against those who dealt with the United States. Under its contract with the Department of Army, Kiewit was prohibited from taking advantage of the credit provisions of the gross

---

[3]The United States also sought to have the license and regulatory provisions of Title 84, Chapter 35, Revised Codes of Montana, 1947, as amended, declared unconstitutional and to enjoin their enforcement against contractors dealing with the United States (J.S. App. 78, 80). The Montana Supreme Court in *Peter Kiewit Sons' Co.* v. *State Board of Equalization*, 161 Mont. 140, 152-153, 505 P. 2d 102, 109-110, determined that the regulatory provisions of the Montana Act were not applicable to the United States, its contractors or its subcontractors (J.S. App. 7, n. 2, 78-79, 121-122).

receipts tax.[4] The Montana Supreme Court determined, *inter alia,* (1) that the gross receipts tax was a revenue enforcing measure, (2) that but for the prohibition in the federal contract against using the credits, Kiewit could have recovered most if not all of the gross receipts tax paid[5] (J.S. App. 111-113), and (3) that the tax did not unconstitutionally discriminate against contractors dealing with the United States. Accordingly, Kiewit was denied the refund sought (J.S. App. 85-86, 105-123).

During the period that the present case was continued, the Montana Supreme Court decided *Peter Kiewit Sons' Co.* v. *Department of Revenue,* 166 Mont. 260, 531 P. 2d 1327 (*Kiewit #2*), which differed from *Kiewit* #1 only in adjudicating the amounts of gross receipts taxes due at different times. The Montana Supreme Court held that its decision in *Kiewit #1* was *res judicata* on the constitutional challenge to the gross receipts tax (J.S. App. 124-130).

After the decision in *Kiewit #2*, the present case was heard on the merits. The appellants contended that the imposition of the gross receipts tax upon contractors dealing with the United States did not violate the Supremacy Clause of the Constitution because the tax was also imposed upon contractors dealing with the State, and that the United States was bound by the decision of the Montana Supreme Court in *Kiewit #1* (J.S. App. 9-10, 20-35, 94-100). The United States' contentions, sustained by the court below with one judge dissenting, were,

---

[4]This contract provision, and the policy embodied in it, have since been abandoned, and contracts after 1971 have required contractors to take advantage of all credits, including credits available for back periods (J.S. App. 11, 91).

[5]Kiewit incurred a personal property tax of $35,803.22 on its heavy equipment. It sought a refund of gross receipts taxes of $8,726.47, and was entitled under Montana law to a refund of that amount (J.S. App. 109, 112).

inter alia, that the gross receipts tax upon contractors dealing with the United States violated the Supremacy Clause of the Constitution because it discriminated without justification against those contractors and in favor of contractors dealing with private entities, and imposed upon the United States costs greater than those borne either by private entities or by the State of Montana (J.S. App. 8-9, 13-17, 92-94). The district court also held that the United States was not bound by the *Kiewit* litigation (J.S. App. 15).[6]

ARGUMENT

1. The district court correctly held that the Montana gross receipts tax discriminated against the United States and those with whom it dealt, and thus violated the Supremacy Clause of the Constitution.

This Court has consistently held that "a tax may be invalid even though it does not fall directly on the United States if it operates so as to discriminate against the Government or those with whom it deals" (*United States* v. *City of Detroit,* 355 U.S. 466, 473). This proscription is inherent in the federal government's immunity from state taxation under the Supremacy Clause. See, *e.g.*, *M'Culloch* v. *Maryland*, 4 Wheat. 316; *United States* v. *County of Fresno,* 429 U.S. 452, 463-464; *Phillips Chemical Co.* v. *Dumas School District,* 361 U.S. 376, 385-387; *Moses Lake Homes* v. *Grant County,* 365 U.S. 744, 751.

---

[6]The opinions of the district court are reported at 437 F. Supp. 354.

In *County of Fresno, supra*, this Court upheld a county tax, authorized by state law, on the possessory interests of those who occupied federally-owned houses on tax-exempt government land. This tax corresponded to the tax which California imposed on the owners of private land, which was "presumably reflected" in the rent which private lessees paid. In upholding the tax on federal lessees, the court reiterated the rationale of *M'Culloch, supra*, that states cannot impose oppressive taxes bearing on a federal function, but taxes bearing on both private and federal interests are subject to a "political check against abuse," and thus are permissible. 429 U.S. at 458. "So long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory * * *." *Id.* at 460. See *James* v. *Dravo Contracting Co.*, 302 U.S. 134 (gross receipts tax imposed on both private and public contractors). Therefore, "the economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituents of the State." 429 U.S. at 462 (footnote omitted). If the tax had not been imposed on private lessees, it would have been invalid as to the federal lessees, for it then would have been discriminatory. *Id.* at 463 n. 11, 465.

The present tax is not "imposed equally on other similarly situated constituents of the State" because it is not imposed on private contractors. It is imposed on federal contractors. Thus its unconstitutionality is clear under the principles of *M'Culloch, supra*, and *County of Fresno, supra*.

The appellants seek to distinguish this situation from *M'Culloch* by pointing out that the tax is imposed not only on contractors for the federal government, but also

on contractors for the state. But, as we now discuss, that fact does not, in the circumstances of this case, suffice to save the tax from unconstitutionality.

If a contractor working on a job for a private party buys a $10 bag of cement and pays a $1 tax on the purchase, the state gains $1 at the expense of the private party. If a contractor working on a contract for the State buys a $10 bag of cement and pays a $1 sales tax, the State reimburses him $11, and gains nothing. If a contractor on a Federal job makes a similar purchase, the federal government reimburses him $11, and the state gains $1 at the expense of the federal government. The state is, in a sense, treating itself better than the federal government, because it pays no tax and the federal government does; however, the tax is nondiscriminatory because the federal government is treated exactly like the private party. Thus the tax does not violate the Supremacy Clause, for the reasons stated in *M'Culloch* and repeated in *County of Fresno*: the state legislature will presumably not impose oppressive taxes on its citizens, so that any tax which puts the federal government to the same burden as the state's citizens is constitutional. In the above example, the fact that the state "pays" no tax is irrelevant; the non-payment simply reflects the fact that the state is transferring money from its left pocket (the contracting office) to its right (the tax collector).

If the tax on private parties is eliminated in the above example, the discrimination against the federal government is evident. The private party pays no tax; the state pays no tax; only the federal government pays tax. There is no check to prevent the legislature from raising the tax to oppressive levels. Its citizens will not protest and the state, though it transfers larger amounts of money from pocket to pocket, in the end pays nothing. The federal

government pays the tax to the state through its contractors, and the discriminatory effect is clear. The tax is invalid under the Supremacy Clause. *M'Culloch* v. *Maryland, supra.*

Thus it is evident that the tax on private parties is the only real protection that the federal government has against discrimination. Once that is eliminated, the federal government stands alone as a true taxpayer to the state. The state's claim that its own contractors must also pay the higher tax is illusory; whatever the contractors pay to the state is reimbursed by the state[7] and, no matter how high the tax, the state pays it from one pocket to another.

The tax in this case is not imposed on private parties. It is imposed only on contractors for the federal government and, ostensibly, on contractors for the State. Because Montana does not, as a practical matter, pay a tax to itself, the fact that the tax here is nominally "imposed" on state contractors is immaterial.

This leaves only the matter of credits. The credits work here to allow a contractor, first, to reduce his gross receipts tax by the amount of personal property tax paid. Then, each contractor pays the gross receipts tax and, in turn, credits the amount paid against his income taxes.

In effect, then, the gross receipts tax is a hostage to other taxes. It goes to satisfy property and income tax obligations. If the amount of gross receipts taxes owed was always insufficient to pay the personal property tax and income tax, there would in effect be no gross receipts

---

[7]The fact that the state reimburses the contractor follows from the hypothesis that the tax is not imposed on private parties. Any tax not reimbursed, directly or indirectly, must be absorbed by the contractor—a private party.

tax at all. Contractors' payments earmarked for gross receipts taxes would reduce other tax obligations, and thus be swallowed up by them. If that were the case, there would be no dispute.

However, the record shows here that such is not the case. The gross receipts taxes are only half-consumed when they are applied to satisfy other taxes; thus, over time, the effective rate of the gross receipts tax has been one-half of one percent. This is a small tax, but it is a real one. It is not paid by private parties. It is not, as shown above, paid in any real sense by the state. It is paid only by the federal government. Therefore it is discriminatory and cannot stand under the Supremacy Clause.

The opinion of the Montana Supreme Court in *Kiewit #1,* upon which appellants rely, reasons that, because state contractors and United States contractors alike pay the tax, the state is treating the federal government as well as it is treating itself and thus there is no discrimination. See J.S. 19-20. But as shown above, such reasoning is fallacious.

The dissenting judge below argued (J.S. App. 28) that the government's reasoning "if followed to its logical conclusion" would effectively invalidate state gross receipts taxes upon all contractors, or sales taxes imposed upon all purchasers of goods, which taxes were upheld in *Alabama* v. *King & Boozer,* 314 U.S. 1, and *James* v. *Dravo Contracting, supra,* Appellants adopt this contention (J.S. 12-16). The answer is simply that, for the reasons shown above, the reasoning is not carried "to its logical conclusion." Taxes such as those in *King & Boozer* and *Dravo Contracting* are valid, even when imposed on a contractor for the federal government, because they pass muster under *M'Culloch, supra,* and *County of*

Fresno, *supra*: they are imposed equally on all similarly situated constituents—provate as well as governmental—in the state. The tax involved here is not.[8]

Appellants contend (J.S. 16-25) that the district court misapplied the holding of *Phillips Chemical Co.* v. *Dumas School District*, 361 U.S. 376. According to the appellants, *Phillips Chemical* requires only that, in taxing those with whom the federal government deals, the state must treat such persons "as well as it treats those with whom [the state] deals itself." 361 U.S. at 385. Because the state here taxes its own contractors at the same rate it taxes federal contractors, the appellants conclude, as the Montana Supreme Court did, that the state has met the test of *Phillips Chemical* and the tax is therefore valid.

In *Phillips Chemical*, the state of Texas taxed lessees of federal property at a higher rate than it taxed lessees of state property. The Court observed that "it does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself." 361 U.S. at 385. It found the special tax for federal lessees invalid because "it still remains true, as it has from the time of *M'Culloch* v. *Maryland*, 4 Wheat. 316, that a state tax may not discriminate against the Government or those with whom it deals." *Id.* at 387.

---

[8]The fact that the tax is imposed on receipts from local governments, school districts and other governmental entities makes no difference, even assuming that those entities, like the federal government, cannot recoup those payments occasioned by the tax (see J.S. App. 12). Once it is shown that the State is discriminating against the federal government, the tax must fall; its constitutionality cannot be restored by showing that the state is also discriminating against other governmental entities.

Appellants focus on the language requiring the state to treat federal lessees as well as it treats state lessees and from that point conclude that the tax here is valid because it is imposed on both federal and state contractors. This superficial analogy is not valid, however, because, as shown above, the burden of the tax falls on the federal government and not on the state government. Contrary to appellants' assumption, *Phillips Chemical* announced no new test of discrimination, much less a test that could be satisfied by the scheme which appellants have implemented here. It explicitly adhered to the principles expressed by this Court in *M'Culloch*: if the tax discriminates against the federal government or those with whom it deals, the tax is invalid. As shown above, such is the effect of this tax.

Finally, appellants' attempt (J.S. 23-25) to bring the present case under the aegis of *County of Fresno, supra*, is unpersuasive. Their claim is that the tax here was "uniform on all taxpayers similarly situated—i.e., contractors having construction contracts for *any* public entity * * *." J.S. 24. Such an approach defines the relevant "market" too narrowly. It would for example, validate a statute which taxed occupants of property owned by federal, state, or local governments but exempted occupants of privately-owned property. Such a tax would fail the *Fresno* test because federal lessees would be "worse off * * * than those * * * in the private sector," 429 U.S. at 465. The fact that the state lessees might also be worse off would not, of course, make the tax any the less unconstitutional as applied to the federal lessees.

2. The district court also correctly held that the federal government was not precluded from litigating the merits by the decision in *Kiewit #1*, a case that one of its contractors litigated. The appellants contend (J.S. 26), as the dissenting judge did (J.S. App. 23-27), that the United States is barred from litigating the merits of this case

under the rationale of *England* v. *Medical Examiners*, 37[illegible] U.S. 411, and under the doctrine of collateral estoppel.

a. *England* held that parties who initially present their federal claims to a federal court cannot litigate those issues in that court where (1) the federal court abstains and sends the parties to state court for a resolution of state law grounds, (2) those parties "freely and without reservation" litigate all their claims in the state courts, (3) the parties in each action are identical, and (4) the state court has jurisdiction over the parties. These conditions are not met here.

First, the district court never invoked the doctrine of abstention. The parties to this litigation merely agreed to continue the case while the state courts considered *Kiewit #1*, in which the federal government appeared only as *amicus curiae*. Second, in agreeing to the continuance, the United States never "freely and without reservation" submitted its claims to the state court. The state court never acquired jurisdiction over the federal government. Indeed, in this action, the federal government seeks a judgment of the effect of the tax with respect to all of its contracts. The *Kiewit* case involved only one type of contract—and that one no longer effective. See note 4, *supra*. The rule in *England* thus did not prevent the district court from reaching the merits of the dispute here.

b. The decision in *Kiewit*, moreover, did not determine the issue here. Because of the amount of Kiewit's heavy equipment in Montana, it was not established that the gross receipts tax here in question would have imposed any financial burden upon the contractor. Had Kiewit claimed the credit, its personal property tax could have eliminated all of the public contractor's gross receipts tax. Indeed, the Montana Supreme Court proceeded upon the assumption that there might in all cases be "a total washout of the 1% gross receipts payments" (J.S. App. 109, 111-113).

In this case, to the contrary, the effective rate of the tax the United States ultimately bore, after taking all credits available, will be approximately one-half of one percent of the contractors' gross receipts (J.S. App. 11, 87, 88). Considering principles of collateral estoppel as well as *England*, therefore, the district court was correct in holding that the decision of the Montana Supreme Court in *Kiewit* was no barrier to its judgment in this case.

CONCLUSION

The judgment of the district court should be affirmed.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

M. CARR FERGUSON,
Assistant Attorney General.

DAVID ENGLISH CARMACK,
Attorney.

MAY 1978.

DOJ-1978-05